(25)

No. 92-1384

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

BARCLAYS BANK PLC,

Petitioner,

vs.

FRANCHISE TAX BOARD, An Agency of the State of California,

Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF CALIFORNIA IN AND FOR THE THIRD APPELLATE DISTRICT

BRIEF *AMICUS CURIAE* ON BEHALF OF REUTERS LIMITED IN SUPPORT OF PETITIONER BARCLAYS BANK PLC

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QUESTION PRESENTED

Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional when such application poses discriminatory compliance burdens on such entities.

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INTEREST OF *AMICI*

Reuters Limited ("Reuters"), one of many subsidiaries of Reuters Holdings PLC, a United Kingdom company, supplies news and financial services worldwide. Reuters does business in approximately eighty countries throughout the world. Reuters is a party to litigation with the New York State tax authorities challenging the constitutionality, under the Foreign Commerce Clause, of the very heavy compliance burden imposed upon Reuters by New York State's worldwide reporting requirements.

The New York Court of Appeals decided that case adversely to Reuters on October 12, 1993. *Reuters Ltd. v. Tax Appeals Tribunal*, No. 186, slip op. (N.Y. Oct. 12, 1993). Reuters currently is evaluating whether to petition this Court for a writ of certiorari.

Reuters submits this brief because the instant case presents the same issue of burdensome compliance under California law, and to underscore the importance of that issue to foreign multinational corporations that, as part of their worldwide operations, do business in the United States.[1]

SUMMARY OF ARGUMENT

California's imposition of worldwide combined reporting on multinational corporations doing business in California does not conform to the international standard and imposes a substantial burden on multinational corporations. In the taxation of multinational corporations, it is the international norm that only the corporation's home jurisdiction — and not any other — may require the corporation to restate all of its books and records worldwide in accordance with that country's accounting standards. However, under California's system, corporations doing business in numerous countries throughout the world are required to keep their books and records for all of their worldwide operations not only in conformance with their home country's practice, as the international norm requires, but also in conformance with California's unique tax requirements. The cost of conforming a multinational corporation's books and records to California's tax requirements is substantial, and may even dwarf the tax owed. Moreover, if other countries deviated from the international norm so that multinational corporations were required to restate all of their books and records to conform with the tax and accounting requirements of every country in which they do business, the compliance costs could be so prohibitive that they would prevent many corporations from engaging in international business.

[1] The petitioner and respondent have consented to the filing of this brief.

ARGUMENT

I. REQUIRING FOREIGN MULTINATIONAL CORPORATIONS TO RESTATE ALL OF THEIR BOOKS AND RECORDS IN ACCORDANCE WITH CALIFORNIA'S SPECIFICATIONS VIOLATES THE LONGSTANDING INTERNATIONAL NORM ESTABLISHED TO AVOID THE PROBLEM OF BURDENSOME COMPLIANCE

It is the international norm that a multinational enterprise keep all of its books and records in conformance with the requirements of its home country. It is *not* the international norm that a multinational enterprise keep *all* of its books and records in accordance with the tax and accounting requirements of *every* country in which it does business. Instead, with respect to a non-home country jurisdiction, only the books and records of the multinational enterprise's operations in that country must conform to the host country's requirements. This practice is known as "separate accounting."

In 1933, the League of Nations conducted a study of international taxation that examined the effects of two alternative methods — separate accounting and formulary accounting — to determine the taxable income of a local branch of a multinational corporation. Mitchell B. Carroll, Methods of Allocating Taxable Income, in Taxation of Foreign and National Enterprises, League of Nations, Volume IV (1933). Because worldwide combined reporting of international corporate groups did not then exist, the issue of separate accounting versus formulary apportionment of worldwide income arose in the context of international branch operations. The issue was whether the branch's income considered earned within the host country should be calculated by separate accounting or as a percentage of the worldwide income of the enterprise of which it was a part. The report noted that "separate accounting ... is preferred by the great majority of Governments, and business enterprises represented in the International Chamber of Commerce, as well as by other authoritive groups." *Id.* at 189 (footnotes omitted). The report concluded that separate accounting was a more

appropriate system than formulary accounting for taxing a local branch of a multinational corporation.

> Various Governments which apply the method of fractional apportionment maintain that the total net income shall be computed in accordance with their own legislation, even though only a very small part thereof may be attributed to the local branch. This involves not only determining gross income from sources in one or more foreign countries, but also allowances for business expenses, bad debts, depreciation, losses and other allowable deductions. . . . Its determination under its own law of income clearly arising in other countries would usually be different from the amount determined under such other countries' own laws. Perhaps many establishments of a large foreign enterprise have no direct or even an indirect relationship to the establishment within the taxing State.
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> The requirements under fiscal or commercial law for maintaining accounts, the differences in accounting methods, in language, in currency and the incidental problems of evaluation and exchange all tend to support the method of separate accounting. Moreover, the Customs requirements of the different countries tend to force a segregation of the business profits realised [sic] therein.

Id. at 188 (footnote omitted).

Today, virtually without exception, the nations of the world – including the United States – determine branch income by separate accounting. "Separate accounting is the method of taxation in use generally throughout the world and is employed by the federal government." Letter from James A. Baker III, Secretary of the Treasury, to Dan Rostenkowski, Chairman, House Ways and Means Committee (March 5, 1986).

There is a sound reason why the international norm requires that a multinational corporation maintain all of its worldwide books and records only in accordance with the tax and accounting standards in its home country. If every country required multinational corporations to recast all of their worldwide books and records to conform with its tax and accounting rules, many multinational corporations likely would be unable to continue to conduct international business. That is why the federal government follows the international norm. California should not be permitted to upset the international equilibrium.

II. REQUIRING FOREIGN MULTINATIONAL CORPORATIONS TO RESTATE ALL OF THEIR BOOKS AND RECORDS TO CONFORM WITH CALIFORNIA'S SPECIFICATIONS IMPOSES AN UNCONSTITUTIONAL BURDEN ON FOREIGN COMMERCE

The state of California applies worldwide combined reporting to determine the taxable income of California subsidiaries of multinational corporations.[2] Pursuant to this approach, the California Franchise Tax Board determined the taxable income of Barclays Bank of California, a California affiliate of Barclays, a multinational corporation, by applying a percentage[3] to the total income of the entire Barclays enterprise. The total income sum included the income from Barclays Bank of California, Barclays Bank International ("BBI"), Barclays Bank Limited ("BBL"), and 50% or greater subsidiaries of BBI and BBL. Consequently, much of the income included in the total income sum was derived from the business of corporations and affiliates outside California and the United States. *Barclays Bank v. Franchise Tax Bd.*, 14 Cal. Rptr.2d 537, 539 (Ct. App. 1992), *cert. granted*, __U.S.__, 114 S. Ct. 379 (1993).

[2] Although the focus of this case is the use of the worldwide income of a corporate group to determine the California income of a separate corporation, the California system of formulary taxation would impose the same burden on a multinational company organized as a single corporate entity with branches in California and elsewhere in the world.

[3] The California Franchise Tax Board determined the percentage by applying the formula described at Cal. Code Regs., tit. 18, § 25128-25136.

California law required Barclays to recast its income earned from all of these entities in conformance with California's tax reporting rules. California's rules incorporate many, but not all of the Federal tax reporting rules. Moreover, a great many of California's tax reporting requirements do not appear in the tax codes or accounting rules of other countries. Consequently, requiring Barclays to restate all of its books and records to conform with California's rules entails considerable compliance difficulties. To cite just a few examples of federal law incorporated into California law:

- 26 U.S.C. § 267 (1988) disallows deductions for transactions between "related" taxpayers. The statute treats certain related persons, as well as some persons who are not literally "related," as related for purposes of the statute. Deductions that are disallowed under this section are often permitted under the laws of many foreign countries. *See* Cal. Rev. & Tax. Code § 24427 (West 1992).

- 26 U.S.C. § 368 (1988) and related sections constitute a complex system of law for determining when corporate combinations are held to produce current income to the constituent corporations, the degree to which corporate characteristics carry over, 26 U.S.C. § 381 (1988), and formula limits on the use of certain carried-over items, 26 U.S.C. § 382 (1988). Transactions qualifying for nonrecognition treatment under foreign law will often be recognized as producing current income under these sections of the code and vice versa. Moreover, foreign law will never mirror the precise and detailed carryover provisions of § 381 and § 382. *See* Cal. Rev. & Tax. Code § 24451 (West 1992).

- 26 U.S.C. § 453 (1988) contains detailed rules that govern when a taxpayer can report sales for periodic payments on the "Installment method." Special rules are provided for among others, dealers, sales between related persons, and revolving credit plans. These rules are also unique to United States taxing systems. *See* Cal. Rev. & Tax. Code § 24667 (West 1993).

- 26 U.S.C. § 988 (1988) creates a highly sophisticated system of taxing foreign currency gains or losses — rules which have not been adopted in any other country. Under these rules, a foreign currency gain or loss attributable to a "Section 988 transaction" receives separate treatment from that given to the gain or loss on the underlying transaction. While California law incorporates Section 988, it has not incorporated amendments to Section 988 made by the Federal Technical and Miscellaneous Act of 1988 concerning dispositions of non-functional currency and transactions involving foreign contracts, future contracts and other instruments. Thus, the California system of computing foreign currency gains and losses is unique — it differs from the federal system and from the systems of *all* foreign countries. *See* Cal. Rev. & Tax. Code § 24905 (West 1992).

The cost of conforming the worldwide books and records of a multinational corporation to these and other requirements is substantial. The trial court found that it would cost Barclays over $5 million to establish, and over $2 million annually to maintain, a system that would allow compliance with California's requirements.

It is little wonder that the United States government has criticized California for its imposition of worldwide combined reporting. In a letter to George Dukmejian, then Governor of California, George Schultz, then Secretary of State, noted the heavy compliance burden that California's system imposes on foreign commerce.

> The administration of the worldwide unitary method of taxation . . . imposes unreasonable and costly compliance burdens on an enterprise which is considered to be part of a worldwide unitary group. . . . [I]n the case of foreign-controlled entities which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other reason, [it] will require costly conversion. . . .

Letter from George P. Schultz, Secretary of State, to George Dukmejian, Governor of California (Jan. 30, 1986).

Worse, the imposition of such costly burdens on foreign corporations clearly is discriminatory. As noted, the international norm requires only that a multinational corporation maintain its books and records in accordance with the tax and accounting standards prevailing in its home country. Because the United States follows this norm, United States corporations that conduct business in California will encounter little difficulty in satisfying California's tax reporting rules; for they already are required to compile the information mandated by California's system to comply with federal tax law. Foreign corporations, however, are not.

The California Court of Appeals recognized that California's reporting system imposes a substantial — and highly discriminatory — burden on foreign-based multinational groups, such as Barclays.

> Foreign-based corporate groups incur greater administrative costs to comply with California's WWCR system than do their domestic-based counterparts. In a nutshell, this distinction between domestic and foreign-based multinationals is a result of the following: while domestic-based multinationals keep most of their records in English, in United States currency and in accord with United States accounting and tax accounting principles, the same cannot be said for multinationals based abroad. For the foreign parent, some of the information may not be available because different nations use different accounting methods. The information that does exist is not always in the language, in the currency, and in accord with the accounting principles just noted. Significant costs are incurred in obtaining the necessary information on a worldwide basis, and translating and transforming it to these modes.
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> [A]ll witnesses agreed that with customarily and currently available accounting data, literal compliance with WWCR requirements is impossible for foreign multi-nationals . . . .

Barclays Bank, 14 Cal. Rptr.2d at 546 (citations omitted).

Consistent with separate accounting, Barclays reports the local operations of its separate national branches or subsidiaries in compliance with local rules. Moreover, consistent with the international norm, the United Kingdom, Barclays' home country, requires Barclays to report its worldwide activities in accordance with the United Kingdom's accounting rules. Requiring that Barclays prepare another set of worldwide accounts for some sixty countries in accordance with United States and California tax accounting rules imposes an unconstitutional burden on foreign commerce.

CONCLUSION

For the reasons discussed above, this Court should reverse the judgment below and declare the California system of worldwide combined reporting unconstitutional.

Respectfully submitted,

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